UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
HAMMOND DIVISION

IN RE:	)	
	)	
THOMAS JOSEPH CAHILLANE,	)	CASE NO. 04-65210 JPK
	)	Chapter 7
Debtor.	)	
**********		
GORDON E. GOUVEIA, TRUSTEE,	)	
Plaintiff,	)	
v.	)	ADVERSARY NO. 05-6144
TC INVESTMENTS, LLC, CHARLES R. SPARKS, and RONALD K NABHAN,	)	
Defendants.	)	

ORDER CONCERNING DEFENDANTS' MOTION TO AMEND THEIR PLEADINGS ("DEFENDANTS' MOTION")

This procedural matter is before the court on the Defendants' Motion to Amend Their Pleadings (record entry #135), and the Trustee's Response to Defendants' Motion to Amend Their Pleadings (record entry #159). The defendants – TC Investments, LLC, Charles R. Sparks and Ronald K. Nabhan – advance two contentions for their assertion that issues under 11 U.S.C. § 548(c) and 11 U.S.C. § 550(b) should be allowed to be presented to the court at the trial of this adversary proceeding. The first of these contentions is that these issues of "good faith" and the provision of "value" were implicitly raised by the defendants' denial of allegations stated in the plaintiff's amended complaint, and that these issues are not affirmative defenses at all. The second contention is that if these issues do constitute affirmative defenses, Rule 15(a)(2) allows the amendments to be made in the interests of justice.

Turning to the first contention, there is no case which the court's research has discovered which is binding on the court in relation to whether or not the assertion of 11 U.S.C. § 548(c) and/or 11 U.S.C. § 550(b) by a defendant involved in an action under 11 U.S.C. § 548(a) is an affirmative defense. In other words, there is no case in the United States Supreme Court, in the United States Court of Appeals for the Seventh Circuit, or in the United States District Court for the Northern District of Indiana which has directly addressed this issue.

Without citing them, the court's research has disclosed that other courts have, at least in passing, discussed this issue, and have pretty much uniformly determined that at least 11 U.S.C. § 548(c) is an affirmative defense in response to an action under 11 U.S.C. § 548(a). The United States Court of Appeals for the Seventh Circuit has somewhat scantily addressed the standards to be employed to determine whether or not a party's contention is an affirmative defense. The court's research discloses the following standard stated in *Fort Howard Paper Company v. Standard Havens, Inc.*, 901 F.2d 1373, 1377 (7th Cir. 1990), *rehearing & rehearing en banc denied*, May 24, 1990:

> The evidence necessary to establish a breach of warranty claim is significantly different from that required to prove the misuse of the baghouse or hindrance of the contract. Misuse concerns whether the breach of warranty was the proximate cause of the damages. *See Burrus v. Itek Corp.,* 46 Ill.App.3d 350, 4 Ill.Dec. 793, 360 N.E.2d 1168 (1977). Hindrance concerns Fort Howard's impairment of Standard Havens' ability to perform its part of the contract. *Cenco, Inc. v. Seidman & Seidman,* 686 F.2d 449, 453 (7th Cir.1982). As such, the alleged defenses do not controvert Fort Howard's proof of breach of warranty and, therefore, are properly labelled affirmative defenses. *See J. Moore,* Moore's Federal Practice ¶ 8.27[3] (2nd Ed.1985). Affirmative defenses must be pleaded, as the district court recognized, in accordance with Rule 8(c) of the Federal Rules of Civil Procedure.
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> The primary purpose of Rule 8(c) is simply to guarantee that the opposing party has notice of any additional issue that may be raised at trial so that a party is prepared to properly litigate it. *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation,* 402 U.S. 313, 350, 91 S.Ct. 1434, 1453-54, 28 L.Ed.2d 788 (1971). Therefore, as relevant to this case, "[t]he policy behind Rule 8(c) is to put plaintiff on notice well in advance of trial that defendant intends to present a defense...." *Hardin v. Manitowoc-Forsythe Corp.,* 691 F.2d 449, 458 (10th Cir.1982). *See also Allied Concrete, Inc. v. N.L.R.B.,* 607 F.2d 827 (9th Cir.1979). We conclude, as did the trial court, that Standard Havens' Answer fails to meet these notice requirements. The Answer merely stated generally that Fort Howard "failed to fulfill its obligations under the Contract" and then listed several contractual obligations. Such a general statement of obligations is not sufficient under Rule 8(c) to give Fort Howard fair notice of the defenses of misuse and hindrance. Therefore, the district court did not abuse its discretion in concluding that the pleadings did not

adequately give notice of the defenses.

The standard, stated without further elucidation, is if alleged defenses controvert the proof required to sustain a plaintiff's direct contentions, they do not constitute affirmative defenses – while if alleged defenses do not controvert the proof requirements of a directly asserted action, they are properly labeled as affirmative defenses. Included in this somewhat nebulous "test" is the concept that a plaintiff must be put on notice of an asserted defense, no matter how the defense is ultimately labeled.

In the instant case, the amended complaint in the context of this motion asserted an action under 11 U.S.C. § 548(a)(1)(B) against Sparks in Count V, and asserted an action under 11 U.S.C. § 548(a)(1)(B) against Nabhan under Count VI. The defendants generally denied the material averments of the amended complaint in both of these counts. The question that arises is whether general denials of a claim under 11 U.S.C. § 548(a)(1)(B) are sufficient to allow the defendants to assert 11 U.S.C. § 548(c) and 11 U.S.C. § 550(b) to defeat the plaintiff's alleged actions without separately asserting affirmative defenses under those two statutory provisions. A critical element of proof under 11 U.S.C. § 548(a)(1)(B) is that stated in § 548(a)(1)(B)(i), i.e., that the debtor "received less than a reasonably equivalent value in exchange for such transfer . . .". Obviously, the burden of the plaintiff in the action is to establish the value received in relation to the value of the property transferred, and in this context, the elements of proving value or lack thereof to establish the plaintiff's case necessarily involve "value" given by the defendants in the transaction. The issue of "value" is parallel under § 548(a)(1)(B)(i), and under 11 U.S.C. § 548(c) and 11 U.S.C. § 550(b). The element of "value" is not a matter which controverts issues raised by the plaintiff, but is rather an integral part of the issues which the plaintiff must prove. A general denial of the allegations of the plaintiff's action is sufficient to present the element of "value" to the court under 11 U.S.C. § 548(c) and 11 U.S.C. § 550(b).

However, there is a second component to both 11 U.S.C. § 548(c) and 11 U.S.C.

§ 550(b), and that is the "good faith" of the transferee. Is this component in and of itself a sufficient matter of avoidance to require the assertion of affirmative defenses? In one context, 11 U.S.C. § 548(a)(1)(B) does not look to the intent of the transferor with respect to the transfer, but rather addresses factors which cause a transfer to be a constructive fraud on creditors by denying creditors the value of property transferred. Moreover, § 548(a)(1)(B) does not involve review of knowledge by the transferee with respect to the circumstances of the transfer, or potential complicity by the transferee in the transfer. Viewed in this manner, the "good faith" components of § 548(c) and § 550(b) do not controvert the § 548(a)(1)(B) allegations, and may in this context be deemed to be affirmative defenses. Let's look a little more closely. In order to establish the action under § 548(a)(1)(B), additional elements in addition to lack of reasonably equivalent value must be established, as stated in § 548(a)(1)(B)(ii). The plaintiff's amended complaint in Counts V and VI proceeded on this prong under §§ 548(a)(1)(B)(ii)(I), (II) and (III). These elements of proof by the plaintiff do not involve analysis of the transferee's knowledge of the transferor's circumstances, or potential complicity by the transferee in the alleged constructively fraudulent transfer. These elements do not implicate – in the context of §§ 548(c) and 550(b) – the "good faith" of the transferee, and thus the assertion of "good faith" on the part of the defendants does not controvert the elements required to be established by the plaintiff under 11 U.S.C. § 548(a)(1)(B)(ii). Because of the "good faith" element of the asserted defenses to the plaintiff's action, the contentions that the defendants may assert provisions of §§ 548(c) and 550(b) constitute affirmative defenses. As a result, analysis under Fed.R.Bankr.P. 7015/ Fed.R.Civ.P. 15(a)(2) is necessary.

Amendments to pleadings before trial, in the context of this motion, are governed by Fed.R.Bankr.P. 7015/Fed.R.Civ.P. 15(a)(2), the latter of which states:

> (2) *Other Amendments.* In all other cases, a party may amend its pleading only with the opposing party's written consent or the court's leave. The court should freely give leave when justice so

requires.

The United States Court of Appeals for the Seventh Circuit has well-defined standards for the application of the foregoing Rule. In *Soltys v. Costello*, 520 F.3d 737, 743 (7th Cir. 2008), the following was stated:

> Federal Rule of Civil Procedure 15(a) provides that if a party is not entitled to amend a pleading as a matter of course, it may amend "with the opposing party's written consent or the court's leave." The court "should freely give leave when justice so requires." Fed.R.Civ.P. 15(a)(2). "Although the rule reflects a liberal attitude towards the amendment of pleadings, courts in their sound discretion may deny a proposed amendment if the moving party has unduly delayed in filing the motion, if the opposing party would suffer undue prejudice, or if the pleading is futile." *Campania Mgmt. Co. v. Rooks, Pitts & Poust,* 290 F.3d 843, 848-49 (7th Cir.2002). Delay on its own is usually not reason enough for a court to deny a motion to amend. *Dubicz v. Commonwealth Edison Co.,* 377 F.3d 787, 792-93 (7th Cir.2004); *Perrian v. O'Grady,* 958 F.2d 192, 194 (7th Cir.1992). But " 'the longer the delay, the greater the presumption against granting leave to amend.' " *King v. Cooke,* 26 F.3d 720, 723 (7th Cir.1994) (quoting *Tamari v. Bache & Co.,* 838 F.2d 904, 908 (7th Cir.1988)).

In the earlier case of *Perrian v. O'Grady*, 958 F.2d 192, 193 (7th Cir. 1992), a slightly more expanded list of factors to be considered with respect to the negative impact of an amendment was stated:

> Any time after a responsive pleading has been served, a party must seek leave from the court or written consent of the adverse party to amend a pleading. *Amendola v. Bayer,* 907 F.2d 760, 764 (7th Cir.1990) (citing Fed.R.Civ.P. 15(a)). While leave to amend is to be freely given when justice so requires, Fed.R.Civ.P. 15(a), it is "inappropriate where there is undue delay, bad faith, dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, or futility of the amendment." *Villa v. City of Chicago,* 924 F.2d 629, 632 (7th Cir.1991) (citing *Foman v. Davis,* 371 U.S. 178, 183, 83 S.Ct. 227, 230, 9 L.Ed.2d 222 (1962)). It is within the sound discretion of the district court whether to grant or deny a motion to amend. *Campbell v. Ingersoll Milling Mach. Co.,* 893 F.2d 925, 927 (7th Cir.1990). A court of appeals will overturn a district court's denial of a motion to amend only if the district court has abused that discretion by not providing a justifying reason for its decision.

> *J.D. Marshall Int'l, Inc. v. Redstart, Inc.,* 935 F.2d 815, 819 (7th Cir.1991).

Finally, in the earlier case of *Fort Howard Paper Company v. Standard Havens, Inc.*, 901 F.2d 1373, 1379-1380 (7th Cir. 1990); *rehearing & rehearing en banc denied*, May 24, 1990, the following was stated:

> Courts have consistently held that leave to amend should be "given when justice so requires[,]" *Bohen v. City of East Chicago, Ind.,* 799 F.2d 1180, 1184 (7th Cir.1986); *City of Columbia v. Paul N. Howard Co.,* 707 F.2d 338 (8th Cir.1983); *Joseph v. United States Civil Service Commission,* 554 F.2d 1140, 1147 (D.C.Cir.1977); *Hilgeman v. National Ins. Co. of America,* 547 F.2d 298, 303 (5th Cir.1977), and that the leave sought should be freely given. *Knapp v. Whitaker,* 757 F.2d 827, 849 (7th Cir.1985). Nevertheless, as we stated in *Feldman v. Allegheny Intern, Inc.,* 850 F.2d 1217, 1225 (7th Cir.1988), FRCP 15(a) "is not a license for carelessness or gamesmanship. Parties to litigation have an interest in speedy resolution of their disputes without undue expense. Substantive amendments to the [Answer] just before trial are not to be countenanced and only serve to defeat these interests. The district court must consider the harm when deciding whether to grant leave." The judicial system cannot allow parties to freely void orders by their agreement.
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> It is wholly within a district court's discretion to deny an amendment to the pleadings for delay and prejudice to the opposing party. *Bohen,* 799 F.2d at 1185; *Knapp,* 757 F.2d at 849. In the parties conditional stipulation they agreed to allow the amendment only if Fort Howard was permitted new discovery on the defenses. Apparently, the district court was concerned that if it had allowed the addition of the new defenses of misuse and hindrance the parties would be forced to reopen discovery, including the gathering of new evidence, and the identification of appropriate legal arguments. All this would have taken time if the parties were to have an opportunity for meaningful trial preparation, which would result in additional expenditures by the parties. *See Feldman,* 850 F.2d at 1225.
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> Beyond prejudice to the parties, a trial court can deny amendment when concerned with the costs that protracted litigation places on the courts. Delay impairs the "public interest in the prompt resolution of legal disputes. The interests of justice go beyond the interests of the parties to the particular suit; ... delay in resolving a suit may harm other litigants by making them wait longer in the court queue. Hence, when extreme, 'delay itself may be considered prejudicial'." *Tamari v. Bache & Co. (Lebanon) S.A.L.,*

838 F.2d 904, 909 (7th Cir.1988) (quoting *Andrews v. Bechtel Power Corp.,* 780 F.2d 124, 139 (1st Cir.1985)).

Amalgam of the foregoing standards results in a clear favoring of allowance of amendments in order to present all matters involved in the case to the court at trial, so that "justice" can be done based upon all circumstances and legal theories which can properly be advanced before the court. This overriding policy is tempered by considerations of improper motives on the part of the party proposing the amendment; futility of the amendment; or undue prejudice to the opposing party by virtue of allowance of the amendment. A fourth factor, less pertinent than the previously designated three factors, is delay in seeking the amendment; however, delay is not in and of itself a reason for denying a Rule 15(a)(2) motion.

The element of prejudice can be alleviated by continuance of the trial to allow the party opposing the amendment the opportunity to conduct discovery regarding the issues raised by the amendment and to prepare a case in response to the amendment.

The court's record demonstrates that the circumstances of the transactions involving the debtor Thomas J. Cahillane and the defendants, TC Investments, LLC, Charles R. Sparks and Ronald K. Nabhan, have been the subject of extensive discovery, and determination by the court of a summary judgment motion filed by the defendants – with respect to every count in the amended complaint – which involved extensive and exhaustive submissions by both the plaintiff and the defendants as to all of the circumstances surrounding the alleged transfer transaction. As stated above, the court deems the standard for amendment of pleadings before trial enunciated by the United States Court of Appeals for the Seventh Circuit to clearly favor amendment of pleadings to present all issues before the court which are implicated in a case, so long as certain negative factors are not involved in the late presentation of those issues. First, as the analysis of whether or not the defendants' assertions even constitute affirmative defenses indicates, that determination is far from easy or clear. Absent extensive research and

analysis parallel to that of the court, the defendants could have in good faith deemed their general denials to have implicated the affirmative defenses which they now seek to assert. There is thus no bad faith in the defendants' request to amend their answer to assert affirmative defenses in this context. The record establishes to the court's satisfaction that the plaintiff's position with respect to the defendants' positions did not arise until the parties actually sat down and attempted to prepare a final pre-trial order, and thus the raising of these affirmative defenses at this time is not deemed by the court to involve undue delay or dilatory motive on the part of the defendants. There was no prior issue in this case as to the need to amend the answer, and thus the defendants have not failed to amend their answer when given an opportunity previously by the court to do so. The amendment of the pleading proposed by the defendants is certainly not futile, as the court has seen enough of this case in its review of the parties' assertions in order to determine the defendants' summary judgment motion to know that the good faith of the defendants as transferees may give rise to a realizable defense to the plaintiff's action.

We thus come to whether or not the proposed amendments to the pleadings to raise affirmative defenses are prejudicial to the plaintiff. The plaintiff's assertions of prejudice are stated in paragraphs 28 and 29 of his Response. As is true with most statements of prejudice when prejudice is a standard to discuss, these assertions are conclusory and do not substantively establish in detail the manner in which the plaintiff will be prejudiced if these defenses are allowed to be asserted in the trial of the case. It is somewhat difficult for the court to believe that – in the process of the extended discovery involved in this case -- all of the circumstances surrounding the asserted defenses were not the subject of examination by the plaintiff or cross-examination by the defendants in depositions. Be that as it may, if there is any prejudice, there is an easy way to cure it in order to do justice to present this case to the court in all of its facets, including the involvement by the transferee defendants in the transfers at the

heart of the plaintiff's amended complaint against them: to allow the plaintiff to move for continuance of the trial to conduct additional discovery on any issues which have not already been explored in the context of these asserted defenses.

Based upon the foregoing, the court determines the following:

A. The matters sought to be raised by the defendants under 11 U.S.C. § 548(c) and 11 U.S.C. § 550(b) constitute affirmative defenses, which were not raised by the defendants in their response to the plaintiff's amended complaint.

B. Under the standards of Fed.R.Bankr.P. 7015/Fed.R.Civ.P. 15(a)(2), the amendment by the defendants of their answer to the amended complaint to raise the foregoing defenses should be allowed, because justice so requires to present this case properly to the court in all of its facets.

C. The court does not perceive undue prejudice to the plaintiff by allowing the foregoing amendments to the answer of the defendants. However, if the plaintiff deems itself to be prejudiced, the court will entertain a motion by the plaintiff to continue the trial set for January 18, 2011 to allow the plaintiff to conduct discovery regarding these defenses.

IT IS ORDERED as follows:

I. The Defendants' Motion is granted, and the defendants are granted leave to in essence amend their answers to the plaintiff's amended complaint by including the asserted defenses in the final pretrial order.

II. The plaintiff may move to continue the trial to conduct additional discovery with respect to the asserted defenses; any such motion must be filed by December 23, 2010.

Dated at Hammond, Indiana on December 6, 2010.

/s/ J. Philip Klingeberger
J. Philip Klingeberger, Judge
United States Bankruptcy Court

Distribution:
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